

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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date: December 17, 2010

to: R. Craig Schneider
General Attorney (Salt Lake City)
(Small Business/Self-Employed)

from: Stuart D. Murray
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(Procedure & Administration)

subject: Interest Netting Involving Underpayment Interest Paid but Unassessed

This Chief Counsel Advice responds to your request for assistance dated October 1, 2010. This advice may not be used or cited as precedent.

LEGEND

Corporation X =
A =
B =
C =
Date X =
Date Y =
Date Z =
Date XX =
TY1 =
TY2 =
TY3 =
TY4 =

ISSUES

1. Whether the Service may allow a claim for interest rate netting pursuant to section 6621(d) that includes underpayment interest paid but which was never, and cannot now be, assessed.
2. If interest netting is allowable in that circumstance, whether the end date of the period of underpayment interest potentially available for netting is the date the interest was paid or is it some other date, such as the date the amount paid was transferred to Excess Collections.

CONCLUSIONS

1. Assuming all of the requirements for interest netting are met, the Service may allow a claim for netting of the interest rate on underpayment interest that the requesting taxpayer owed and has paid but which the Service did not assess and is barred from assessing.
2. The applicable date for the period of underpayment interest should be the date the Service received the payment of the interest, which is when the interest stopped accruing, rather than the date the Service transferred the amount paid to Excess Collections.

FACTS

Corporation X's income tax return for the fiscal year ending Date X was filed in Date Y. Prior to the expiration of the period of limitations on assessment for the taxable year, Corporation X agreed to extend the limitations period to Date Z. On Date Z, the day the extended period of assessment expired, Corporation X filed an amended income tax return for TY1 showing an additional tax liability of approximately \$ A. Accompanying the amended return was Corporation X's payment of the additional tax, plus \$ B, which was designated by a notation on the bottom of the return as an advanced payment of underpayment interest on the reported tax. For TY1, Corporation X owed underpayment interest of approximately \$ C.

The incoming request for advice does not specify when the amended return was processed but states that the Service did not process the amended return in a timely manner, and more to the point, did not assess the tax reported on the amended return, prior to the expiration of the assessment period. As for the payment, because the additional tax for TY1 could no longer be assessed, the Service transferred the entire payment received (including the amount designated as interest) to Excess Collections.

On Date XX, Corporation X filed an interest rate netting claim seeking to net the underpayment interest for tax year TY1 against overlapping periods of overpayment interest from other tax years (specifically, tax years TY2, TY3, and TY4).¹

¹ Our advice in this memorandum is limited to whether underpayment interest paid for TY1 is available for netting (of interest rates) against allowable overpayment interest for other tax years. Without these other

LAW AND ANALYSIS

Issue 1:

The Restructuring and Reform Act of 1998 (RRA '98) amended section 6621 to add subsection (d), which allows a taxpayer to eliminate the interest rate differential on overlapping periods of overpayments and underpayment. Specifically, section 6621(d) provides that

[t]o the extent that, for any period interest is payable under subchapter A and allowable under subchapter B on equivalent underpayments and overpayments, by the same taxpayer of tax imposed by this title, the net rate of interest ... shall be zero for such period.

Interest netting generally applies to interest accruing on or after October 1, 1998. Rev. Proc. 2000-21 § 1, 2000-1 C.B. 1257; Rev. Proc. 99-43 § 1.01, 1999-2 C.B. 579. The overlapping periods of overpayment and underpayment interest under the facts of this case were after October 1, 1998. For interest periods after October 1, 1998, if the period for refund or credit of underpayment interest is open at the time a netting claim or request is filed, the Service applies interest netting by decreasing underpayment interest. Rev. Proc. 2000-26 § 4.02(1). Alternatively, if that period is closed when netting is claimed or requested, but the six-year period to file suit for additional overpayment interest is open, then the Service applies interest netting by increasing overpayment interest. Rev. Proc. 2000-26 § 4.02(2).

The question raised by the facts you provided is whether the underpayment interest paid with the amended return but not assessed qualifies for interest netting under section 6621(d). Interest netting does not apply to an overpayment or underpayment for any period during which interest is not allowable or payable by law (e.g., the 45-day interest disallowance rule under section 6611(e)). Rev. Proc. 2000-26 § 3.02(3). The answer to your question turns on whether the underpayment interest is payable under subchapter A of Chapter 67—i.e., under section 6601. That section requires that interest be paid by a taxpayer if any amount of tax “is not paid on or before the last date prescribed for payment,” which is ordinarily the date prescribed by section 6072(b) for filing a return on which the tax is required to be reported. I.R.C. § 6601(a), (b). Any tax not paid on or before the due date is an underpayment on which interest accrues. FleetBoston Fin. Corp. v. United States, 483 F.3d 1345, 1351 (Fed. Cir. 2007) (section 6601 “imposes interest for any period during which an amount of tax is both due and not paid”). An extension of time to file a return does not extend the date for payment of tax. Ott v. United States, 141 F.3d 1306, 1309 (9th Cir. 1998). Under section 6601(a), interest on an underpayment is due from the last date prescribed for payment of the tax

years, there can be no overlapping periods of under- and overpayment interest for purposes of section 6621(d).

to the date the underpayment is paid. No consideration is given for an extension of time to pay the tax when calculating underpayment interest. I.R.C. §§ 6601(b)(1), 6151(c); Treas. Reg. § 301.6601-1(c)(1). By filing an amended return, Corporation X self-assessed the additional tax liability shown on the return and admitted to an underpayment of tax (as of the unextended filing and payment due date) and had a pre-existing legal obligation to pay both the tax and the related interest.

Section 6601(e)(1) provides that interest shall be assessed and collected in the same manner as taxes. The Service's ability to assess and collect interest, however, is limited by section 6601(g), which requires that interest be assessed and collected at any time during the period within which the tax to which the interest relates can be collected. To be collectable under section 6502, a tax must have been assessed during the limitations period under section 6501.

Under section 6501(a), the Service must generally assess taxes due within three years of the return being filed (a return filed early is deemed filed on the due date, per section 6501(b)(1)).² The parties can, however, extend the three-year period of limitations for assessment by written agreement, as they did in this case. I.R.C. § 6501(c)(4). In addition to the extension-by-agreement exception, where a taxpayer files an amended return within 60 days of the expiration of the limitations period—again, as the taxpayer did in this case—section 6501(c)(7) extends the period of limitations by 60 days from the date of the filing of the amended return. Despite this additional time, the Service did not timely assess the additional tax shown as due on the amended return.

Once the period of limitations on assessment expires, the Service is time-barred from assessing the tax. Although the Service may assess interest (as opposed to tax) after the limitations period has run, the authority to do so is predicated on an assessment of tax that was timely and is currently collectable as within the period in section 6502(a). Because the Service in this instance is barred from assessing the tax, the tax to which the interest relates is not collectable, and, thus, the Service is also barred from assessing and collecting the related underpayment interest due on the additional tax liability under section 6601(g). See Treas. Reg. § 301.6601-1(f)(1) (interest “may be assessed and collected at any time within the period of limitation on collection after the assessment of the tax to which it relates”).

While the Service may be precluded from assessing the tax and interest, this is not to say that Corporation X was not liable for the additional tax reported on its amended return and related underpayment interest.

An assessment is a bookkeeping entry to record a taxpayer's liability on the government's books. I.R.C. § 6202 (“assessment shall be made by recording the liability of the taxpayer”); Cohen v. Mayer, 199 F. Supp. 331, 332 (D.N.J. 1961), aff'd

² The filing of an amended return does not create a new three-year period. Badaracco v. Commissioner, 464 U.S. 386, 393 n.8 (1984); Zellerbach Paper Co. v. Helvering, 293 U.S. 172, 178, 180 (1934).

sub nom., Cohen v. Gross, 316 F.2d 521 (3d Cir. 1963). The assessment is not the liability itself, does not create the liability, and is not a condition precedent for the liability. Moran v. United States, 63 F.3d 663, 666 (7th Cir. 1995), overruled on other grounds, Malachinski v. Commissioner, 268 F.3d 497 (7th Cir. 2001). When a tax return is required by the Code, such as Corporation X's Form 1120 for tax year TY1, the taxpayer "shall, without assessment or notice and demand ... pay such tax to the internal revenue officer with whom the return is filed, and shall pay such tax at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return)." I.R.C. § 6151(a); see also United States v. Voorhies, 685 F.2d 710, 714 (9th Cir. 1981) ("A tax deficiency exists from the date a return is due to be filed; that deficiency arises by operation of law under sections 6151(a) and 6072(a)."). The assessment simply acts "as a judgment for taxes found due." Cohen, 199 F. Supp. at 332 (citing Bull v. United States, 295 U.S. 247 (1935)). Where taxes and interest legally due are paid before the expiration of the period of limitations for assessment, a taxpayer cannot recover the amounts paid merely because they have not been formally assessed. See Rev. Rul. 85-67, 1985-1 C.B. 364; Williams-Russell & Johnson, Inc. v. United States, 371 F.3d 1350, 1352-53 (11th Cir. 2004); Crompton & Knowles Loom Works v. White, 65 F.2d 132 (1st Cir. 1933) (notwithstanding the requirement that taxes be assessed, the amount sought by the taxpayer, which was interest the company paid, was a sum legally due to the Government and was, therefore, not recoverable).³ The Government is permitted to retain payments received prior to the expiration of the limitations period to the extent the amount does not exceed the amount which might have been properly assessed and demanded. Lewis v. Reynolds, 284 U.S. 281, 283 (1932).

Even though the limitations period on assessment expired, the taxes reported by Corporation X on its amended return were legally due, as well as the associated interest. The key language from section 6621(d) is "interest payable under" the Code. In this context, the underpayment interest was interest that was payable by Corporation X regardless of assessment. The assessment is a prerequisite to the Service's ability to enforce collection of the amount due outside of the period of limitations for assessment, but does not alter the underlying fact that interest was payable on the underpayment.

We conclude that interest due on the underpayment determined by Corporation X on its amended TY1 return was payable within the meaning of section 6621(d). The taxpayer should be allowed the benefit of any interest netting to the extent of the \$ C of payable underpayment interest paid by the taxpayer with the amended return. Insofar as the amount of interest paid may be more than the amount of interest payable, the difference is not available for interest netting.

³ Had payment been received after the expiration of the assessment period of limitations, the payment would not have been legally due the Government and would constitute an overpayment. See Rev. Rul. 74-580, 1974-2 C.B. 400.

Issue 2:

The request for advice asked what the appropriate ending date is for the period of underpayment interest, if we concluded that the taxpayer may use for netting underpayment interest paid for TY1. We agree with your proposed conclusion that given these facts, the ending date should be the date of payment, Date Z. That is the date on which interest on the underpayment stopped accruing. Had the Service timely assessed the amount of tax shown on the taxpayer's amended return, interest on that amount would still have ceased on the payment date.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4940 if you have any further questions.